BEFORE THE COPYRIGHT ROYALTY JUDGES
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In the Matter of:	
MECHANICAL AND DIGITAL PHONORECORD DELIVERY RATE ADJUSTMENT PROCEEDING.	Docket No.: 2006-3-CRB DPRA
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a.m.

A P P E A R A N C E S

Copyright Royalty Tribunal:

CHIEF JUDGE JAMES SLEDGE
JUDGE WILLIAM ROBERTS
JUDGE STANLEY C. WISNIEWSKI

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C O N T E N T S

P R O C E E D I N G S

CHIEF JUDGE SLEDGE: The United States Copyright Royalty Judges are assembled. The order for the court this morning is the mechanical rate proceeding to set the rates and terms in Section 115.

All with matters to be presented before this court please come forward. We will begin today with the Motion for Referral filed by DiMA and proceed from there to the opening statements. Please be seated.

A little bit of organizational at the beginning of this proceeding. For those of you that have not been present in any prior proceedings in this room, there is a cafeteria on the sixth floor, there are restrooms just outside in the corridor by the elevators on this floor. I hope you've had success in getting your materials in. If not, sorry, we can't help you.

(Laughter.)

CHIEF JUDGE SLEDGE: Materials and security and facilities are matters that are

something over which we have very little input.

We announced in our scheduling order our daily schedule. If it's not clear in there, we will try to take a break at noon, try to resume at 1:00 depending on where we are with the witness at that particular time, and we'll try to conclude each day around 4:30. We went to 5:00 in our last proceeding, and that seemed to interfere with all that has to be done outside the courtroom, so we went back to our initial schedule of 4:30 to try to permit time to accommodate all the other things that you and us have to do outside of here.

I believe that covers our administrative matters. We will begin with our motion by DiMA for referral. Mr. Laguarda?

MR. LAGUARDA: Thank you, Your Honor.

JUDGE ROBERTS: Mr. Laguarda, I'd remind you, as well as all the other litigants, to speak as loudly as possible. Unfortunately, the acoustics in this room are not all that great. So if you could speak up, I think we would all appreciate it.

MR. LAGUARDA: Thank you.

CHIEF JUDGE SLEDGE: This room is designed to have a sound system, and if somebody sees it, please let us know.

(Laughter.)

MOTION FOR REFFERAL BY COUNSEL FOR DiMA

MR. LAGUARDA: Thank you, Your Honor. I'll do my best.

May it please the Court, Fernando Laguarda for the Digital Media Association.

The issue on our motion is the pure question of statutory interpretation, that is, whether the term "digital phonorecord delivery" in Section 115 of The Copyright Act should be interpreted to include interactive streaming.

The motion is novel in that no court or other tribunal has addressed it.

As presented in the motion, the question is does interactive streaming of a sound recording constitute a digital phonorecord delivery under Section 115 of the Act.

If it is a digital phonorecord delivery,

then Section 115 applies, and rates and terms should be set by this court, as the copyright owners propose. If it is not a digital phonorecord delivery, then the court need not set rates.

DiMA defines interactive streaming as the playing of a specific sound recording in response to the listener's request without the creation of an audio file that remains accessible on the client computer beyond the playing of such sound recording.

In Section 115, digital phonorecord delivery is defined as the individual delivery of a phonorecord by digital transmission of a sound recording, which results in a specifically identifiable reproduction by or for any transmission recipient of a phonorecord of that sound recording. Interactive streaming does not deliver a phonorecord.

The word "phonorecord" appears twice in the definition of digital phonorecord delivery. The Act clearly defines phonorecord as a material object in which sounds are fixed and from which the

sounds can be perceived, reproduced or otherwise communicated. The definition contemplates something that is fixed, something delivered that the recipient can play at will.

Interactive streaming does not let a user play a fixed record whenever he wants to. Like a song heard on the radio, a song heard via interactive streaming cannot be rewound, played back or otherwise used again. It is, therefore, not fixed for a period of more than transitory duration.

The Act provides that a work is fixed when its embodiment is sufficiently permanent to allow it, or stable to permit it to be perceived or communicated for a period of more than transitory duration.

In looking at the structure of the Act and the definitions, it's clear that digital phonorecord delivery was defined to confirm the traditional commonsense definition of delivering phonorecords. In other words, the intent of Congress was to maintain and reaffirm and not

expand mechanical rights, as technology permitted phonorecords to be delivered by wire or over the airways, rather than the traditional making of records, cassettes and CDs.

CHIEF JUDGE SLEDGE: That's curious. Not intended to expand rights when it goes from something you hold in your hand to something that's digital? It seems like an expansion, doesn't it?

MR. LAGUARDA: It's an expansion of -- technology expands the ability to deliver the phonorecord. It does not expand the rights associated with it.

What Congress said, and the Senate Report says, is that the purpose of creating a digital phonorecord delivery mechanism and rate setting mechanism for that under 115 is to allow for the compulsory license to be used in circumstances where phonorecords are delivered digitally.

The rights in the phonorecords are the same rights that existed before the amendment of the statute, and that's where the legislative history provides some guidance.

It's not an expansion of the rights. It's a recognition that technology can distribute and deliver, as the definition provides, a phonorecord to an end user. But what is being delivered, what is being distributed is a phonorecord, like a cassette, like a CD, like a record, and that's what's clear.

Now, the only federal court that has considered anything related to this issue considered the question of whether downloading a musical file constitutes public performance, and that is the Southern District of New York in connection with rate setting for the ASCAP, a performing rights organization.

CHIEF JUDGE SLEDGE: Is that the citation on page four of your motion?

MR. LAGUARDA: Yes, Your Honor.

CHIEF JUDGE SLEDGE: Your citation is incomplete and inaccurate. That's the Southern District of New York?

MR. LAGUARDA: Yes, Your Honor. Senior Judge Conner in that case, Your Honor, considering

the question of whether there's a public performance in downloading. And that is, I would suggest, a very practical understanding of the statute. The question here is, and the definitions under the Copyright Act, the question here is whether a transmission that is delivering a performance to the end user is the distribution of a phonorecord. And as we are defining it and as the statute makes clear, merely transmitting a song, publicly performing it, does not constitute a digital phonorecord delivery, and that's the legal question that merits referral.

JUDGE ROBERTS: Mr. Laguarda, what's the meaning of streaming?

MR. LAGUARDA: The meaning of streaming is not a legal question. That's a question of, as we have defined it, transmitting a sound recording and a musical work over the Internet and publicly performing it more likely than not.

JUDGE ROBERTS: If we refer this question to the Register, will she not have to define what streaming is in order to answer the question on

whether interactive streaming does not result in a digital phonorecord delivery?

MR. LAGUARDA: The real issue for the Register to grapple with is whether there is a phonorecord, whether a phonorecord is delivered, that is, if a transmission, as we have defined streaming, does not result in the delivery of a phonorecord.

JUDGE ROBERTS: You say how you define it. The question I'm asking, though, is isn't the Register going to have to give a definition to streaming in order to make a determination of whether there is a --

MR. LAGUARDA: Yes, and that's the definition that we have provided; simply the transmission of a sound recording to an end user that does not result in the creation of a phonorecord that the user can then use.

There is no delivery of a phonorecord in streaming because streaming is the rendering of an audio file from a server to the user, and there are copies, as the copyright owners suggest in their

opposition, there may be lots of different ways and mechanisms to deliver the stream to the end user. But the key point is that if the end user does not get a phonorecord, the end user doesn't get something like a cassette, a record or a CD, then it's not a digital distribution, digital phonorecord delivery that is defined in the Act, and that's the key question.

Yes, we are proposing the raw facts that are necessary to answer the question, but it's not dependant on the technology that is involved because the ultimate question is what does the user get. Does the user get a phonorecord delivered to them for their use and enjoyment?

JUDGE WISNIEWSKI: Well, Mr. Laguarda, just to follow-up on that, and I don't mean to interrupt Judge Roberts' colloquy here, but do you have agreement among all the parties as to your definition of interactive streaming?

MR. LAGUARDA: No, Your Honor, we do not. But there is agreement --

CHIEF JUDGE SLEDGE: This seems to come

back to when he asked you if the Register would have to define that. You went on to go on to talk about other things, but the answer is yes?

MR. LAGUARDA: The answer is yes, Your Honor, the Register has to define it, and that's why we proposed a definition in the motion. The definition itself is the simple definition of streaming the transmission of the sound recording to the end user. There are many ways --

JUDGE WISNIEWSKI: So you're really proposing two questions for the Register then, aren't you?

MR. LAGUARDA: No, because the definition of streaming is not a legal question in and of itself.

JUDGE WISNIEWSKI: But you admit the Register has to determine what that definition is.

MR. LAGUARDA: No, the Register, as with Ring Tones, the Register has to understand the general facts that are the context for answering the question of law, but the question of law is simply whether an activity that does not distribute

a phonorecord constitutes a digital phonorecord delivery.

JUDGE WISNIEWSKI: Well, let's assume that the Register were to take your definition of interactive streaming and, in fact, decide this legal question. How far does that advance the ball for these proceedings since you don't have any agreement on what that definition is? Don't we still have to set a rate for where you don't have an agreement?

MR. LAGUARDA: No, Your Honor. For the distribution of the phonorecord to an end user there is at least -- there are three proposals before the court as to what rates should be if there's a phonorecord that's delivered.

The parties are in agreement with respect to that question. That is, where there is a phonorecord delivered, the mechanism of the transmission is what the copyright owners are raising. They are saying that where the end user doesn't get a phonorecord, there should still be a rate set in this proceeding. And the question of

law is whether it's enough to argue all of these factual matters and create a factual basis for setting a rate, or whether the legal question has to be answered that the transmission alone, without the creation of a phonorecord, is within the jurisdiction of rate setting under 115.

And I think that resolving the question to your inquiry, Your Honor, will make it easier for this proceeding because other than referring it, we will have a situation where the court will engage in rate setting and the copyright office will have an opportunity to answer the question at the end rather than before the parties clearly understand what the legal landscape is in defining their rate request.

At the moment there is no clarity for understanding the scope of the statute and what is contemplated by the meaning of the digital distribution by digital phonorecord, and that's why, to answer I think the question that concerns you, it's more efficient for these proceeding to resolve it now. And the work that has to be done

in terms of the definition is no different than on any referral of the question of law or appeal of a question of law. The facts are necessarily going to be defined in a manner that allows the question of law to be answered. But we are not proposing that this is an issue that requires delving into how the stream occurs because the point is what the user gets, and that is not a phonorecord, and that is why Section 115 doesn't apply.

CHIEF JUDGE SLEDGE: The definition of interactive streaming will be based on evidence presented in this proceeding?

MR. LAGUARDA: The definition of interactive streaming if a digital phonorecord delivery contemplates an activity where the user does not get a phonorecord, then the issue of what is interactive streaming and how a rate will be set is a question that could be addressed in this proceeding, Your Honor, but it's not in the record right now.

CHIEF JUDGE SLEDGE: That didn't answer my question.

MR. LAGUARDA: Perhaps if you'd repeat it.

CHIEF JUDGE SLEDGE: Will that definition be determined by the evidence presented in this proceeding?

MR. LAGUARDA: The definition of interactive streaming? The parties have proposed, both the copyright owners and RIAA, have proposed definitions of interactive streaming, but they have not proposed any evidence supporting it, or to the copyright owners justifying any of the technical issues that they propose need to be addressed.

After the legal question is answered as to whether or not a statute contemplates rate setting for that activity, then, yes, if the answer is it does, then this proceeding needs to address the question of what type of activity qualifies for a rate. Does that answer the question?

CHIEF JUDGE SLEDGE: Yes, and it raises several others. As you say, it's not addressed in the direct cases of anyone. How then will it be presented to the Court for determination?

MR. LAGUARDA: Well, from DiMA's perspective it need not be presented because the question, as a matter of law, will be answered by the Register that no rate need be set and, therefore, no record needs to be created.

CHIEF JUDGE SLEDGE: Well, that assumes your argument, that has not seemed to be very persuasive so far, that that legal question does not require a definition of legal streaming to answer the legal question you proposed.

MR. LAGUARDA: Well, Your Honor, if the Register were to answer the question affirmatively that a rate needs to be set for interactive streaming, then the parties need to put a record before the Court in order to answer that question. It currently does not have a sufficient record to answer the question of what is interactive streaming.

But to get back to the point that you were making, the question of law is a question of what is a digital phonorecord delivery. That's the question of law.

The activity for which the copyright owners request rate setting is the transmission of a sound recording to an end user. They have a definition of it. That transmission does not, as they define it or as we define it, the point is that the mere transmission does not deliver a phonorecord to an end user.

Now, the copyright owners might argue that there are circumstances in which there is a phonorecord delivery, and that's a question of fact that can be answered in this proceeding, and there may be a rate for that activity. But the transmission of a sound recording, of an audio file played to a user, in and of itself, does not deliver a phonorecord.

The statute is clear on the point that the creation of the digital phonorecord delivery category was not intended to create by itself new rights. It was intended to recognize the possibility that technology would allow phonorecords, cassettes, CDs and traditional vinyl records to be delivered to end users. That

activity is not what is contemplated in any way by streaming no matter how it's defined.

So if the definition of streaming contemplates that the user gets a phonorecord, then that, of course, is an issue that is subject to rate setting. But the point is that streaming, no matter how it's defined, doesn't leave the end user with a phonorecord. There are copies that may be made, but all of those questions, all of those copies are beside the point with respect to the law.

The law is clear that there must eventually be a phonorecord distributed to the end user, and none of the definitions that avoid that question will result in an orderly rate setting proceeding before this court.

JUDGE WISNIEWSKI: Mr. Laguarda, since there's no agreement among the parties as how to define interactive streaming, why wouldn't we simply refer, instead of the question as you have framed it in your motion, the question as you have intimated the heart of it is, as whether the

playing of a specific sound recording in response to the listener's request without the creation of an audio file that remains accessible on the computer beyond playing of such a sound recording constitutes a DPD as a matter of law? Why shouldn't we refer that question rather than one that includes a definition over which there's some controversy?

MR. LAGUARDA: That sounds -- that sounds likely -- that is the question that we have presented, Your Honor, so I am comfortable with that referral, yes.

JUDGE ROBERTS: Mr. Laguarda, I'd like to ask you a question about the timing of this filing.

MR. LAGUARDA: Yes, Your Honor.

JUDGE ROBERTS: Why did you wait until January 7th of 2008 to ask for this referral? This was certainly an issue present for your members well before this, going back to I guess at least 2001, and why was this not asked to be referred at a much earlier time?

MR. LAGUARDA: The answer, Your Honor, as

we've said in our papers, is that we've been attempting to resolve that question, absolutely has been known to our members.

What hasn't been known to our members has been the development of the proceeding, the Register's intervening decision on Ring Tones, which discussed the relevance or the manner in which the copyright office views industry agreements as opposed to legal definitions, and these things have created uncertainty.

The parties have attempted in good faith to address them. By no means was it an attempt to cause confusion in the proceedings. It was an attempt in good faith to resolve the issue that had not reached fruition. And because these proceedings were commencing, we felt that we had to, had no choice but to put the issue before the court and to get a prompt referral from the copyright office.

JUDGE ROBERTS: Is it your position that the law permits referral of a novel question at any time in the proceeding right up to the moment of

our decision? In other words, are we compelled to refer to this question or any other question that may come up provided that it is before we render our determination?

MR. LAGUARDA: No, Your Honor, I would not make the argument that this court should ignore the orderly conduct of its proceedings in any way. You have to make that determination. However, the statute and the rules clearly provide and encourage the referral process at any point subject to, of course, the determination of the judges as to its appropriateness.

With respect to timeliness here, the operative provision calls for referral as soon as possible. And here we have a situation where the parties were attempting to resolve this other than by referral and were unable to. And the simple fact is that the latter we wait to resolve the question, the more it will interfere rather than the less, and that's why it makes sense to do it now.

CHIEF JUDGE SLEDGE: How long have the

parties been trying to resolve this question?

MR. LAGUARDA: Your Honor, the question has been known to the parties at least since the beginning of the case and the parties have discussed it.

CHIEF JUDGE SLEDGE: Does it not go back to the passage of the amendments and the disputed matters since the --

MR. LAGUARDA: Yes, Your Honor.

CHIEF JUDGE SLEDGE: -- amendments passed?

MR. LAGUARDA: In terms of the statutory interpretation, yes. In terms of its relevance to the proceeding, when the direct cases were filed obviously was the first time the parties had an opportunity to realize that this was an issue presented by the different rate proposals, and it has required the attention of the parties to try to address it.

CHIEF JUDGE SLEDGE: That seems unbelievable.

JUDGE ROBERTS: Does this mean,

Mr. Laguarda, that you've been discussing this with the music publishers and songwriters up to the holidays, and then you realized over the holidays that you're not going to resolve this and that's why it got filed on January 7th?

MR. LAGUARDA: There were very serious discussions, Your Honor, leading up to the holidays, yes, and I believe that I should be able to address the contention that this motion has been filed for purposes of bad faith or delay under the federal rules of evidence by pointing out that there have been settlement discussions. I'm uncomfortable talking about the settlement discussions in detail, but I can tell you that those discussions, in terms of resolving this issue, were very serious and were very involved through the holidays, absolutely. And the problem presented for the parties in this proceeding is there is a Catch 22 between attempting to resolve this and the deadlines required to put on a case in an orderly manner, and so we are not trying to present the Court with the worst-case scenario,

which is conducting the hearings, putting on additional evidence, which will be required in order to define interactive streaming and get all of the technical matters out onto the record, reaching some conclusion and then having the issue addressed by the copyright office as part of an ultimate resolution. That would be the worst-case scenario, which we want to avoid. So given the choices, the better option is to refer the question now. It's not something that we do without recognizing the burden it creates for the copyright owners and for the Court.

JUDGE ROBERTS: You've asked for a referral of interactive streaming. What about conditional downloads? Is there any issue there that that should be referred either at this point or some future date as well?

MR. LAGUARDA: No, Your Honor, I don't believe that there is any dispute about the use of Section 115 to cover the distribution of phonorecords over which users have control even if it is for a restricted period of time.

JUDGE ROBERTS: So we don't have to worry about another motion for referral coming in on that matter?

MR. LAGUARDA: I believe that that is addressed by all of the parties in their cases and it is not an issue that requires any legal findings. If there are no further questions...

CHIEF JUDGE SLEDGE: Thank you.

MR. COHEN: Your Honor, may I?

CHIEF JUDGE SLEDGE: One moment.

Mr. Smith, do you have anything you want to add?

MR. SMITH: Your Honor, I think at this point we will -- if we have any comment, I think it probably makes more sense for the publishers to go first. We don't have a position on the referral motion itself.

CHIEF JUDGE SLEDGE: All right. You probably will not have another opportunity to say anything.

MR. SMITH: Thank you.

CHIEF JUDGE SLEDGE: All right.

Mr. Cohen?

REBUTTAL OF MOTION FOR REFERRAL BY COUNSEL FOR COPYRIGHT OWNERS

MR. COHEN: Thank you, Your Honor.

I think it's clear that in response to the questions of the Court, Mr. Laguarda has conceded that this is not a pure legal question.

If I may, I'd like to respond to each of the judges' questions that Mr. Laguarda has responded to as a way of demonstrating that.

Judge Roberts, you asked if there was agreement on the meaning of streaming. There is not. And what we have done and what the RIAA has done is to propose rates for existing subscription business models that involve interactive streaming without regard to the precise definition of interactive streaming. And the problem with this referral, and its conceded on page eight of DiMA's reply brief, where they say, "Whether certain kinds of interactive streaming" --

CHIEF JUDGE SLEDGE: Let me interrupt you, Mr. Cohen.

MR. COHEN: Yes, sir.

CHIEF JUDGE SLEDGE: There was no provision in this hearing for a reply brief. I realize something was filed, but that wasn't asked for and it's not part of our rules.

MR. COHEN: If I, nonetheless, may use DiMA' reply brief because I think it's an admission.

CHIEF JUDGE SLEDGE: They have filed it?

MR. COHEN: Yes. "Whether certain kinds of interactive streaming, such as the ones outlined on pages five and six of the copyright owner's opposition, fall within that definition," that is their definition, their proposed definition of interactive streaming, "is a question of fact and not fit for a referral.

"Of course, determining whether interactive streaming constitutes a digital phonorecord delivery may involve some inquiry into what interactive streaming is." And therein lies the problem for DiMA.

This is a factual question, and contrary

to what Mr. Laguarda has said, referral of this supposed legal question, which is really a factual question, will, as you asked, Judge Wisniewski, not advance the ball very far because we will demonstrate through the direct case and again on rebuttal, if there's any controversy, that the actual interactive streaming services that are parties to this proceeding fall on the other side of the line from this hypothetical definition. So answering the question, if you could answer their question as a matter of law, which I will address in a moment you cannot, but answering the question about whether something that does not leave a copy accessible on the computer will not save one moment of court time in this proceeding because we will demonstrate through their witnesses that for at least two and perhaps all three of the interactive streaming services that are parties to this proceeding, DiMA members, they, in fact, do leave copies on the computer that are accessible. And then the issue is what is accessible. Another reason why this is a mixed question of fact and

law, because how is the Register going to determine what is accessible on the computer, and we dealt with this in our opposition papers. Is it in a temporary Internet file? Is it in some other file on the computer? Do you stream the first time and then there's a temporary or a less temporary file reside on the computer so the next time the recipient so calls streams, it plays from the computer rather than a new stream coming from some host site?

So these are all factual questions. And the definition of what is accessible is factual, and even if it were legal, and it's not, we will not save any court time because we will prove and demonstrate and offer proof about what are the correct rates for the actual services that are in business that call themselves interactive streaming services, which is not a defined term. Not only is there no agreement on it, everybody admits and concedes that it is a loosely-defined term that applies to a group of businesses. And there is no way where the Register could determine that as a

pure legal matter, and that makes a big difference when compared to the Ring Tones Referral.

Now, we, of course, argued in Ring Tones unsuccessfully that the matter should not have been referred and ultimately tried to persuade the Register of the Ring Tone question that was referred involved factual questions. But the factual questions there related to whether or not the Ring Tone was a derivative work under Section 115 and, therefore, outside of the compulsory license.

We all knew what a Ring Tone was. There wasn't any dispute between the RIAA and the copyright owners as to what the theme was, which we said was outside of 115 and they said was within 115.

We thought there were factual questions that needed to be developed to answer that question precisely, and we have appealed the Register's decision. But here there's no similar way to make a referral because nobody has offered a definition of what is interactive streaming and the issue of

is it accessible on the computer -- Judge Wisniewski, the question that you asked -- is not a referral of a pure legal question because that is not a self-defining term, and it is far from obvious. And there will be evidence developed in this proceeding as to what is accessible, what resides on the computer and, therefore, whether this activity, which we've all loosely called interactive streaming, constitutes DPDs, as we say, under 115 or does not constitute 115, as DiMA now says, under 115. But that requires the development of a factual question. So it's not a question of law. It's not a question that will add to the efficiency of this proceeding. Not one witness will not testify and no -- and no savings will take place at all in terms of the court's time because we have services -- Napster, Rhapsody, Media Net, the leading commercial interactive services -- which we believe deposit copies one way or another, and the technology is complicated, but one way or the another deposit copies on the end user's computer. So we will save nothing by this referral

and --

CHIEF JUDGE SLEDGE: Mr. Cohen, you have answered this question, but let me present it to you so that I'm very clear on what you're saying.

If the determination is made that a delivery that does not create an audio file that remains accessible is not a DPD, then there will be just as many actions in district court to determine whether an audio file that remains accessible has been created as there would be without that kind of thing?

MR. COHEN: Yes, Your Honor. And in addition, we will still be setting rates for the services that call themselves interactive streaming services in this proceeding because they fall, we think we would show as a matter of fact, on the other side of this somewhat artificial line that DiMA is trying to draw, and that is a completely different situation than we found ourselves in, IN the Ring Tone Referral.

We do not have any real world meaning. It is an abstract definition, it remains accessible

on the computer, it finds no home in the Copyright Act, it finds no definition inside or outside of the Copyright Act, and the question is can you answer that as a matter of law. No. Because to answer the question in a meaningful way and ultimately to determine if there's any kind of interactive streaming service that falls outside of 115, and we think not, but to make that determination is a factual determination and the evidence should be developed in this proceeding.

JUDGE WISNIEWSKI: Doesn't that factual determination have to be judged against some standard?

MR. COHEN: Which --

JUDGE WISNIEWSKI: Go ahead.

MR. COHEN: No, Your Honor. Please.

JUDGE WISNIEWSKI: Well, the question then is would it be fruitful at all to inquire as to what are the essential characteristics of the DPD and an incidental DPD under the law?

MR. COHEN: Respectfully, no, because it is inherently a factual question, and I think the

Copyright Royalty Judges, as contemplated under the statute and under the regulations, are perfectly capable of making that legal determination and applying law to facts as you do in the course of each of these proceedings. So to ask an abstract question, even getting past the problem that it's a mixed question of law and fact, will not guide the Court in any way because the only intelligent way, I respectfully submit, to make that determination is to actually understand what it is that the services do. What is it that they do? They're not radio. Mr. Laguarda said they're radio. They're not radio.

The reason why they are interactive -- radio is not interactive -- the reason why they are interactive is, we will demonstrate, because of various technologies that allow immediate access to some kind of file either on RAM or on the hard drive or a temporary Internet file that is a DPD.

There is no way to answer that question as an abstract legal question. So, with respect, answering that question will not help us because we

won't know whether services fall inside or outside of that definition and it is an artificial construct designed by DiMA for some purpose that I don't fully understand, but it's not even an industry term of art that it remains accessible on the computer. That's not a term that's capable of interpretation by the Register without testimony, without factual background, without a description. We're going to have representatives of these services. We will ask them, the Court can inquire, as to the technology that is used to transfer music to the ultimate user. And it makes no sense to ask that question in the abstract even if you could get past the ambiguity in their question.

Now, if I can turn to the timing point because it is important because Mr. Laguarda began his presentation really on the merits of why he thinks it's clear that interactive streaming, as he defined it, is not a DPD. But the question I thought for today was is the referral appropriate under 354.1 and 354.2 of the regs, and it's inappropriate for two reasons. One I think I've

already covered. There are factual questions. 351.1, the material question, and 354.2, the novel material question, are reserved for pure questions of law, and DiMA has conceded and I've argued already this morning, this is not a pure question of law.

The second infirmity, which Mr. Laguarda addressed in questions from Judge Roberts, is the timing question, and that's very problematic I think both for this proceeding and as a matter of going forward for us today.

DiMA has read as soon as possible out of the regulations. Their reading is as long as you can refer a question so it can be completed by determination consistent with the Register's obligation to decide within 14 days for material questions and 30 days for novel questions. Their reading is as long as you can get there by the end and as long as the Court has not set a deadline, it's time limit.

Well, that might be an interesting argument if 351.1 did not say "as soon as

possible." And in response to your question, Chief Judge Sledge, this has been going on for yours. Everyone knew since 2001 there were, way before this proceeding was filed, that there was a potential legal dispute between DiMA, whose members have actually launched their interactive streaming services by entering into commercial contracts in which they've admitted, but they now seek a referral to achieve the opposite end -- they've admitted in those contracts, and we'll put it into evidence, although we understand that it's not binding on Your Honors' determination -- but they have admitted in the contracts in the deals that were entered into in 2001 that I will actually address in my opening, they've admitted that interactive streaming is an activity that falls within 115. So they obtained rateless licenses, they've bickered with us back and forth for years, there were discussions in the context of potential amendment to the potential so-called 115 Reform Bill, which would have clarified this, they allowed us to go forward and file the case knowing we would

seek a rate, knowing that the RIAA would seek a rate. They sat there when the RIAA filed its Ring Tone Referral to clarify the matter before the direct case was filed, and they come and they say way hoped to settle, so we didn't want to rock the boat. And with respect to Mr. Laguarda, it has nothing to do with Christmas.

I mean the fact of the matter is there have been discussions on and off, and I don't think it's appropriate to use the settlement privilege as a sword and shield, and I think that's what DiMA is trying to do by raising these settlement discussions but shielding the substance of those discussions from this Court. But it is not appropriate to use the settlement discussions as a sword and shield, and even if it were, they say in their papers on page two of their opening brief that the discussions continue in earnest even though they have filed this referral.

So there's nothing about the filing of the referral that necessarily puts an endpoint, a period on the settlement discussions. So it does

not excuse their delay. We're sitting here. We are opening in a few minutes on interactive streaming, and DiMA could have filed this and should have filed this in an orderly way at the beginning of 2006, certainly no later than when the Ring Tone Referral was filed, and we could have had a determination of this question if it were appropriate. We still would have opposed on the issues that I've raised today that it's not a pure question of law, but if it had been referred back in 2006, we could have shaped our direct case in reliance on the Register's direction and, instead, we're talking about a process that if the Court were to refer the question promptly, given the timing that's been part of these earlier proceedings and given the need to have adequate briefing for the Register and given the fact that the Register has 30 days to answer a novel material question of law, we will not have any guidance from the Register before the first phase of this trial is done. And allowing DiMA to throw in this motion at 11:59, whether it's around Christmas or after

Christmas, just upsets the orderly presentation in this case. They have known from before we filed our case that we would seek rates for interactive streaming. They knew that the services that actually filed these individual participants, Media Net, Napster, which has now withdrawn, and Real Networks, Rhapsody, are, in fact, interactive streaming services for which we were going to seek rates. And to allow them to come in at the end and say we really hoped to settle just doesn't ring true and it's not an excuse. They have run roughshod over the 354.1 requirement that the motion be filed as soon as possible.

CHIEF JUDGE SLEDGE: Any questions? Thank you.

Mr. Laguarda, any brief comments?

MR. LAGUARDA: Your Honor, first, with respect to our reply, we filed it pursuant to the rules and were not aware that we were not permitted one. There was certainly one permitted in the Ring Tone Referral, and if it's appropriate, I would ask the Court's leave to reconsider not allowing the

filing of that reply.

CHIEF JUDGE SLEDGE: What ruling? Our order provided that the parties would respond to the motion.

MR. LAGUARDA: Yes, sir.

CHIEF JUDGE SLEDGE: It didn't provide for anything other than a response to the motion.

MR. LAGUARDA: Yes, Your Honor, that is correct, the order that covered Daubert and motions with respect to oppositions on relevance grounds.

There wasn't an order with respect to other motions, but that was the understanding that we had, that the rules provided for the opportunity for reply.

With respect to Mr. Cohen's argument about timeliness, Your Honor, I do not dispute that the parties have been aware of this issue. The fact is that the rules should not be interpreted to prohibit the parties from attempting to resolve disputes, and attempting to resolve the dispute and attempting to settle it took place when it did in earnest between the parties, and that process was

the process that we are representing to you led to our determination that we would be unable to resolve it before the case commenced. And we believed it was important for the Court to have the opportunity to get the guidance from the copyright office as to the legal question and so we believe we are doing it as soon as possible consistent with the rules.

With respect to the legal question, the statute clearly provides that a digital phonorecord delivery is the delivery of a phonorecord. That's the question that the Register must answer. What is the delivery of a phonorecord? Is a phonorecord delivered whenever there is a transmission? Is the simple making of the transmission enough to deliver a phonorecord?

Mr. Cohen makes much about all of the different technologies that can be implicated, but it's a simple legal question and a standard that needs to be set in order to address all of the facts, and the facts to Mr. Cohen's point are not in the record. And the rules clearly provide that

the direct cases are limited to the written direct statements of the parties, none of which address the complicated questions that Mr. Cohen admits need to be resolved if, if the statute allows for rate setting for this activity. And so I don't know exactly what he's contemplating, but there is no evidence that will be put into the record at this point in time with respect to this question, and certainly answering the legal issue first makes sense so that the parties can address the facts in an appropriate and efficient manner. Thank you.

JUDGE ROBERTS: Let me ask a question, Mr. Laguarda. If we referred the question of is a transmission a delivery of a DPD, how could the Register possibly come back with any answer other than it depends?

MR. LAGUARDA: The Register will provide guidance as to what must be delivered. So the answer it depends may be the lay answer, but the copyright law answer will be very specific. The copyright law answer will be is transmission alone delivery of a distribution of a digital phonorecord

to an end user. Is transmission enough? What are the meanings of those legal terms, those terms in the statute? The answer may well be it depends, as it was in Ring Tones, it depends. But the guidance is important to answer the question properly. Without the guidance we're going to go on a wild goose chase to define something currently not in the record without any parameters, without any standards and hope for the best. And that is a worse outcome than the inconvenience of the motion.

JUDGE ROBERTS: Well, I think I hear you saying now that you're not really looking for the Register to define what is an interactive stream, you're looking for the Register to define the word "transmission" because the word "transmission" appears in the definition?

MR. LAGUARDA: No, Your Honor, I believe that as the Court has, or Judge Wisniewski appropriately inquired with respect to the motion, the question does involve an understanding of the activity at a very basic level, what is an interactive stream. But the answer to the question

is the meaning of the statutory terms; delivery, digital phonorecord, distribution. Those are statutory terms that the Register can answer with respect to their meaning. And the definition of streaming in the motion is a way to address it. That's why the question is there, because it comes up in that activity.

JUDGE ROBERTS: And what about the word "transmission"?

MR. LAGUARDA: I believe that the word "transmission" has a definition.

JUDGE ROBERTS: So you're saying that she can expand upon that or give some particulars to that?

MR. LAGUARDA: No, Your Honor. The question is whether a transmission of a sound recording that does not result in a phonorecord being delivered to an end user is subject to rate setting here. It's not the transmission. It's whether the user is getting a phonorecord.

JUDGE ROBERTS: That's what I thought you said originally and then it sounded as if you were

focusing --

MR. LAGUARDA: I'm sorry.

JUDGE ROBERTS: -- on the word "transmission" in your --

MR. LAGUARDA: No, I'm not focusing on that word.

JUDGE ROBERTS: Okay. All right.

CHIEF JUDGE SLEDGE: That last statement you made, "does it result in a phonorecord," even if everyone concedes that 115 requires the delivery of a phonorecord, then you still got the factual dispute as to whether a specific transmission is a phonorecord?

MR. LAGUARDA: There's no doubt that with a standard in place there would still be factual disputes, and that's I believe what Mr. Cohen is referring to in terms of a record needing to be put before the Court to decide what actual activity is implicating digital phonorecord delivery. And his position is that that activity includes things that are interactive or things that are not interactive, and there's a line between the two of them. And

Section 114 talks about interactivity. Section 115 talks about digital phonorecord deliveries. That's the question here. Not interactivity.

CHIEF JUDGE SLEDGE: But in this proceeding, I know you've talked about the limits of the direct cases presented, but in this proceeding the services that provide interactive streaming who are participants or on which we receive evidence can be resolved factually as to whether that stream or transmission results in a phonorecord.

MR. LAGUARDA: I'm not sure that we put forward witnesses -- if the question is can, on cross-examination or by you or the Court's questioning, can the particular witnesses from these services answer --

CHIEF JUDGE SLEDGE: No, that's more of a detailed question than what I'm asking.

Notwithstanding the limits at this point in time as to what evidence can be presented, but this proceeding has within its context a determination of services on which evidence is

presented as to whether that delivery results in a phonorecord.

MR. LAGUARDA: There are services who will testify in this proceeding who engage in a variety of activities, including streaming, interactive streaming, delivery of permanent downloads, delivery of conditional downloads. Those services' activities span a gamut.

The issue is whether a particular activity is subject to rate setting here, and that question is a question of law as to the boundaries of Section 115. They may engage in activities over which there is no 115 rate that can be set, and that's the meaning of this referral motion. Whether or not that particular activity by one of these services is streaming activity, interactive streaming, streaming, the transmission of a sound recording to an end user, that does not distribute a phonorecord deliver a phonorecord to that end user is subject to rate setting here. But you are correct that there are parties in this proceeding who engage in streaming activities, if that's the

question.

JUDGE WISNIEWSKI: Mr. Laguarda, let me ask you about the boundaries of your question. If the facts were to show that an audio file remains accessible on the client computer beyond the playing of a sound recording, do you concede that that, in fact, is a DPD as a matter of law?

MR. LAGUARDA: A legal standard needs to be answered as to what accessible means in this context, but if accessible means that it is usable in the way that the statute seems to imply, which is that it's like a record, like a cassette, then, yes, absolutely. But the question that needs to be answered is what is the meaning of that term and the ambiguity of the term "phonorecord" and the mere existence of a copy, and perhaps the question, as Mr. Cohen is referring to it, is for purposes of infringement or for purposes of technology that there may be a copy, an instantaneous copy, but is that the phonorecord Congress intended when it created this mechanism? Is it just copies that are made? Any copy? Is Mr. Cohen requesting rates to

be set for all Internet transmissions that result in any copies at any time? No. He's drawn the line. He's drawn the line in terms of interactivity. But that's not the line Congress drew. Congress drew the line in terms of a phonorecord being delivered to the end user.

JUDGE WISNIEWSKI: Well, then haven't you fell short in terms of the questions that you'd like to see referred to the Register because you're suggesting by the answer to the question that I raised that the Register would have to determine what does accessibility mean in the legal sense?

MR. LAGUARDA: The Register has to determine what a phonorecord is in this context.

JUDGE WISNIEWSKI: You said accessibility in the legal sense as well.

MR. LAGUARDA: There's a definition of phonorecord in the Act, and that definition applied here with respect to a delivery of a phonorecord to an end user is the question.

JUDGE WISNIEWSKI: We're going in circles here, Mr. Laguarda.

MR. LAGUARDA: Perhaps I don't understand the question. I apologize.

JUDGE WISNIEWSKI: Let me go back and take you through the questions that we just went through. Perhaps we can get to the substance of this.

I said to you if, in fact, the facts were to show that an audio file remains accessible on a client computer beyond the playing of a sound recording, would you concede that such a thing as a DPD for legal purposes here. You said no, that, in fact, the Register would still have to determine legally what the word "accessible" meant. Are you backtracking now? Does she not have to do that?

MR. LAGUARDA: She has to determine whether or not the user gets a phonorecord, as intended by the statute. If that means accessible, then that's part of her determination.

The question is whether or not it has to be accessible, whether or not the phonorecord is a mere copy, or is the phonorecord what the statute seems to say it is, which is something that

substitutes for, something that does not expand on rights but is merely comparable to a CD, a record or cassette. The user gets that and enjoys it like a traditional phonorecord.

Thank you, Your Honors.

CHIEF JUDGE SLEDGE: Thank you. We will recess for ten minutes, so a quarter to the hour, and then resume with the opening statements.

(Brief recess.)

CHIEF JUDGE SLEDGE: Thank you. Come to order.

All right. On opening statements, Mr. Cohen, I believe you will be first.

OPENING STATEMENT BY COUNSEL FOR COPYRIGHT OWNERS

MR. COHEN: Thank you. May it please the court. My name is Jay Cohen. I'm here with my colleagues from Paul, Weiss, Rifkind, Wharton & Garrison, and Mayer, Brown & Platt, and we represent the copyright owners, that is the songwriters who create the songs that are the subject of the 115 compulsory license and the music

publishers who promote, license and administer the copyrights in those works.

Our clients include two of the largest songwriter associations in the United States; the Songwriters Guild of America, which we will sometimes refer to as SGA, the Nashville Songwriters Association International, the NSAI, and the National Music Publishers Association, NMPA, the largest music publishing trade association in America.

If I could, Your Honor, Mr. Israelite, who is sitting at the end of the second table, is the Chief Executive Officer of the NMPA. Mr. Bogard, next to him, they're all going to testify, is the head of the NSAI, and Mr. Carnes, the third person over, is the head of the SGA, and I think, if I read the transcript correctly, there was a custom at the beginning to introduce counsel who will be on their feet. So if I can briefly introduce the Court to Ms. Bayard, my partner, Mr. Johnson, and Mr. Brown, who are all from Paul Weiss, and Mr. Bloch, from Mayer Brown, who will

appear as counsel for EMI.

CHIEF JUDGE SLEDGE: And, counsel, I should have mentioned this earlier, to help me and the court reporter, if all counsel will please identify yourself as you speak.

MR. COHEN: Your Honor, I've given to counsel for the RIAA and for DiMA, if I may approach, I have some demonstrative exhibits to use in connection with the opening. Some of these, as it's labeled, contain restricted information and because of the open proceeding, what I will do is refer the court to the specific tabs without discussing any of the restricted information so we don't have to have any issue with respect to the openings.

Now, this is a landmark proceeding of critical importance for the songwriters and other copyright owners whose musical works are subject to the compulsory license.

There has not been a litigated proceeding under Section 115 since 1980, when the rate was changed from 2.75 cents to 4 cents.

After that litigation, the songwriters and music publishers on the one hand and the recorded music industry on the other have entered into a series of voluntary agreements. The first was in 1987, which provided for CPI increases from the rate that was in existence after the 1980 proceeding. It started at 5 cents and went up by CPI. And the second voluntary agreement was entered into in 1997, which provided for not CPI increases per se but step increases every other year.

And if the Court will turn to Tab 1, where we have summarized those historical rates since 1981. The point and the effect is that even as a result of these various agreements and step increases in the rate, the fact of the matter is that the 4 cent rate that was established in 1981 adjusted for inflation, although not precisely intended, essentially yields the 9.1 cent rate today. Put another way, the songwriters and music publishers have been standing in place with respect to the statutory rate for 27 years on an inflation

adjustable basis.

Now, with all of these prior proceedings, a 1981 proceeding and the 1987 agreement, dealt only with physical product.

There has never been a proceeding to set a rate for the digital delivery of music, although in the 1997 agreement the songwriters and the publishers agreed with the RIAA that the mechanical royalty for permanent downloads only -- what we basically will talk about is iTune downloads in this proceeding, although iTunes didn't exist in 1997 -- that for permanent downloads the rate was set by agreement in 1997 at the same rate as for the physical rate. So today that rate is 9.1 cents as well.

For other types of digital delivery of music, both conditional downloads and the interactive streaming that we talked about this morning, the copyright owners entered into a deal in 2001 with the RIAA which was essentially, and I'll talk about this a bit more, essentially was a rateless deal. It allowed the subscription

services, as they have arisen, to develop and launch in return for some modest advances, the parties agreed that the rate for those services would either be set by negotiation, which has not occurred, or in this proceeding.

Now, as I'm sure it's obvious to the Court from the written direct cases of the parties, and will no doubt be made clear when counsel for RIAA and DiMA get up, there is a vast gulf between the parties as to what constitutes a reasonable rate for both physical and digital product for the period through 2012, which is at issue in this proceeding. And what I've tried to do for the convenience of the Court in Tab 2 is to summarize two pages, in tabular form, the rates that the parties are seeking. And as you can see from Tab 2, there really is a tremendous group.

The songwriters and music publishers, who, as the evidence will show, their mechanical revenues have not been keeping pace with the step increases in the rate, are seeking an increase in the mechanical rate for physical product to 12

and-a-half cents per song.

The RIAA, on the other hand, proposes a percentage of revenue rate, but we should not be confused by the expression of that rate as a percentage of revenue. In fact, as I set out in Tab 2, they are seeking a draconian reduction and their percentage of revenue rate on a penny basis is 5 cents; the rate that was in effect in 1986, putting to one side inflation.

On the digital side we are seeking on permanent download an increase from 9.1 cents to 15 cents per download for the reasons and under the economic theory that I will describe in a few minutes.

Again, the positions couldn't be more different. If we turn to Tab 4, what the Court will see is that when the positions of the RIAA are translated into cents instead of a percentage of revenue and when the DiMA rate is translated into cents as opposed to a percentage of revenue, what the RIAA is seeking for digital downloads is slightly in excess of 5 cents a song, a little more

than half the current rate, and what DiMA is seeking on a percentage of revenue basis for digital downloads is a reduction to 4 cents, less than the current rate.

And with respect to conditional downloads and interactive streaming and Ring Tones, and I will address all of them in my opening, RIAA and DiMA are seeking similarly bargain-basement rates for other types of digital delivery that would, in essence, choke off the trickle -- what is now a trickle, but will choke off the mechanical royalty payments to the songwriters.

Now, the impact of their proposals on songwriters and the other copyright owners would be ruinous. Because of piracy, a lot of which we will discuss today, and other factors, the current rates, although they provided for step increases, have not resulted in an increase in mechanical royalties that was expected at the time the parties entered into their 1997 agreement.

As the heads of the two songwriter groups, Mr. Carnes and Mr. Bogard will testify

songwriters in particular have borne the brunt of this shortfall in mechanical royalties. Although there are a limited number of success stories, and to some extent Mr. Carnes and Mr. Bogard are success stories in the songwriting business, few, if any, songwriters make a lot of money being a songwriter, and even for those who support themselves being professional songwriters, their lot is a hard one.

What they will testify to and what the other songwriters who will testify in this proceeding will explain to the Court is that even at the current rates with step increases, the declining number of sales of songs has resulted in account royalties that have not met their expectation, that have not kept pace with the increases under the statutory rate and, if not turned around in this proceeding, will undermine one of the principal purposes of this proceeding, which is to maximize the availability of creative works, because as they will explain to the Court, if this trends continues, we'll soon be out of

songwriters.

Now, I mentioned the songwriters at the beginning because if you review the submissions by DiMA and the RIAA in this proceeding, you would think that this was merely a dispute between record labels on the one hand and music publishers on the other. And, in fact, Mr. Smith this morning said he would go after the music publishers. But this is not a case, and I do not represent just music publishers, this is not a case solely between corporate music publishers who are copyright owners and corporate users who are record labels because at the bottom the parties who will be most affected by these rates are songwriters who write the songs that the record labels record and the digital companies distribute.

Now, it's true, and the testimony will show, that songwriters typically entrust music publishers with the right to promote and license and administer the copyrights in the songs that they create. But the music publishers retain only a small fraction of the mechanical royalties that

are paid, and that fraction is decreasing, whereas historically, and certainly at the time of the 1980 proceeding, a common deal in the music business was for songwriters to retain half of the mechanical royalties and music publishers to retain half, 50/50 deals.

What the evidence will show is that the paradigm today is for songwriters to get 75 percent of the mechanical royalties and for publishers only to retain 25 percent. And there will be testimony that in many deals that rate is moving towards as high as 90 percent in favor of songwriters.

So the real economic party in interest on the copyright users' side, which is completely hidden from view in the submission of DiMA and the RIAA, are songwriters, who get the overwhelming share of mechanical royalties that are paid.

Now, let me turn to reasonable rates, and we've had the benefit recently of a decision from this Court in the SDARS that obviously informs what we're trying to do in this proceeding, and as this Court is aware, the task is to set a reasonable

royalty that satisfies the 801(b) factors. And I know those factors are well known to the Court, but just for ease of reference I've set them out in Tab 5. And those four factors, of course, are to maximize the availability of creative works, to afford copyright owners a fair return, to give a fair income under existing conditions to the copyright users, to assess the relative roles of the copyright owners and users, to minimize disruptive impact.

Now, as the Court instructed us in the SDARS' decision, page 32, and, again, I've excerpted, just so we're all on the same page, the lang from Your Honor's opinion, "The appropriate starting point for setting a rate under 801(b), a reasonable royalty, is to look at the comparable market royalty rates and these benchmarks should then be used to set the rate unless the policy objectives in 801(b) require some kind of diversion from those rates." And as this Court stated in the SDARS' decision, and in an admonition that we intend the follow, the 801(b) factors should not be

judged one by one as a beauty contest. The question is whether these objective factors, the factors under 801(b) as a whole, require some departure from marketplace rates. And that is exactly how we have constructed our rate proposal for reasonable royalties.

The copyright owners determined that the benchmarks provided by the market, and which I'll go through in a few minutes, outside of Section 115 licensing require an increase in the current statutory rate for physical product, they require an increase in the current statutory rate for downloads, and they require the adoption of rates for other digital distribution that reflect the market value of their work.

Now, our economist who will testify on this is Professor William Landes from the University of Chicago Law School, and he's a pioneer in the field of law and economics, and he has compared our proposed rates against market benchmarks involving the same rights, involving the same parties, and concluded that the rates sought

by the songwriters and music publishers are reasonable because they fail squarely within, in fact, at the low end of the range of reasonable rates, and the evidence will show that there are no policy factor under Section 801(b) that would require this Court to depart from those market comparables.

So what I would like to do is go through our rates one by one and explain what the market comparables are. And, again, for the ease of the Court, I've set out our rates separately in Tab 7, and I'll begin with our rate for physical phonorecords, which is the 12 and-a-half cent rate.

The key difference -- really two key differences between our proposed rate for physical product and that proposed by the RIAA is that we are seeking an increase, they're seeking a cut in half, and we are proposing to maintain the penny rate structure that has been in place for a hundred years as a way of measuring the appropriate royalty rate, and they are proposing a percentage of wholesale revenue.

Now, fundamental to our request for an increase is that since 1997, because of developments in this industry, statutory mechanical royalties have not kept pace with the actual step increases in the royalty rate.

What the evidence will show is that the emergence of all these digital technologies that we began to talk about this morning has spawned lots of new methods of distribution ranging from permanent downloads to limited downloads to interactive streaming to Ring Tones, and those digital delivery mechanisms have transformed the recording music business and they've allowed record companies to sell their product without the high costs of physical manufacture and distribution because CDs aren't pressed, CDs aren't shipped, and they're not sold on the digital side at traditional retail stores.

But here's one thing that the parties actually agree upon in this proceeding: The outbreak of piracy, of illegal music. Since the beginning of the digital age there has been a level

of piracy that is unprecedented in the recording music business.

The impact on all of the parties, record labels, music publishers and songwriters alike, has been severe. The songwriters and music publishers have been hard hit by piracy because it has undermined one of the fundamental bedrocks of prior statutory rate making that publishers and songwriters would be paid on every copy of a song that was in distribution.

The fact of the matter is, is that there are countless millions of songs that consumers are listening to every day which are obtained illegally and for which copyright owners, songwriters and music publishers receive nothing under the mechanical license.

Now, when the music publishers and songwriters agreed to the rate that became the 91 cent rate in 1997, the expectation of those copyright owners was that they would be paid a penny on virtually every copy of every song and all the parties agree no one foresaw the immense amount

of piracy that has occurred in the digital age and, as a result, the expectations of the copyright owners with respect to what would happen with respect to sales when they entered into the 1997 agreement has not been met. I think that that is graphically demonstrated in Tab 8.

Tab 8, which is extracted from the report of one of our experts, shows, and this is restricted information, what has happened with wholesale revenue over time in the recording music business. And if the Court looks at the time of the last agreement, which was 1997, what it sees is that with some dips and some changes for more than a decade that rate of increase of revenue and, therefore, the number of songs that were going to be paid mechanical royalties had increased dramatically, and that continued to about 2000. And from 2000 forward largely, but maybe perhaps not exclusively as a result of piracy, there has been a significant decline in industry revenues. That has upset one of the fundamental assumptions on which the 1997 rate was set or agreed to at

least from the songwriter and music publisher side.

What the evidence will show, and among other witnesses, you will hear from the chairman of the NMPA, Irwin Robinson, a long-time publisher who was one of the principal negotiators of the 1997 agreement, what you will hear is that their expectation in 1997 was the same that it had been in 1987, that we were in a digital boom era -- CD, rather, boom era in which revenues would continue, the number of songs sold would expand, and while the actual penny rate that was agreed to was not as high as songwriters and publishers might have liked and probably not as low as the record labels would have liked, that whatever shortfall there was on a unit basis would be made up on volume. And now what's crystal clear is that that is not going to occur on the digital side, and since 2000 there has been a material decline in the number of CD sales, meaning that there had been a shortfall in the mechanical royalties and that the expectations, at least on our side, and I think on both sides, of the 1997 agreement have not been met.

There's a second piece of evidence that the Court will hear that has been undermining the effect or the impact of --

JUDGE WISNIEWSKI: Mr. Cohen --

MR. COHEN: Yes.

JUDGE WISNIEWSKI: How are those expectations relevant to what we consider?

MR. COHEN: Well, I think that the parties' agreement in 1997, in looking at what the current statutory rate is, is relevant.

JUDGE WISNIEWSKI: In what sense? I mean how is that going to help us determine the rate?

MR. COHEN: I'm going to come to the benchmarks, but I think what it shows is that it shows --

JUDGE WISNIEWSKI: That's fine. I will wait.

MR. COHEN: The historical context. I will come to the specific benchmarks.

There is a second piece of evidence that is important in terms of understanding how the current mechanical rate works, and that's what's

called the control composition clauses. And although the statutory mechanical royalty is 9.1 cents today, the record companies have long sought to reduce the mechanical royalties by imposing on their recording artists controlled composition clauses. Those are agreements between record companies and recording artists that say if you record an album for us, if you record a CD for us, we will not pay the full statutory rate, we will cap the statutory rate, we will reduce it in typically in one of two ways. Either by limiting the number of songs on which a mechanical would be paid or imposing on the album a fraction of the statutory rate. We'll pay 75 cents -- 75 percent of the existing mechanical rate. However applied, either one of these two ways or in other ways, the effect has been to reduce the actual mechanicals that are paid to songwriters and music publishers below the statutory rate.

Now, let me talk a little bit about investments made both by songwriters and music publishers in creating musical work because there's

been a lot of discussion on the other side of the table about music publishers and songwriters really don't contribute.

We are going to present testimony of a number of talented songwriters and they will tell you about the personal and financial sacrifices and the sweat equity that's being discounted on the other side that they put into creating the songs that are recorded. And what they will tell you and explain to the Court is that for songwriters, even hits produce only modest returns, and the hits are few and far between.

On the music publisher side, one of the underlying reasons for our seeking an increased rate is the substantial investment that music publishers make in developing the creative works that are recorded by the record companies.

Now, what the RIAA will do is they will parade into this courtroom witness after witness who will simply refer to music publishers as passive coupon clippers who don't do anything other than administer licenses, collect royalties, and

allocate checks to songwriters.

Presumably this testimony is going to be offered to persuade the Court that the RIAA wins a third of the 801(b) factors for relative contributions of parties.

The evidence is all to the contrary, and we will present the evidence from a number of -- testimony from a number of music publishers. They will testify about the important and material contribution that songwriters make to the creation of the musical works that the record companies record that the digital distribution companies will sell, they will tell the Court that they spend tens of millions of dollars scouring for talent, finding songwriters, supporting songwriters, they promote songs, they protect the copyrights in songs, they license the songs. And what you will hear, which is perhaps most relevant to that factor, is that the music publishers advance hundreds of millions of dollars in advances against royalties to songwriters. And although it is true that those advances are recoupable, what the evidence will

show both qualitatively and quantitatively is that a substantial amount of the advances that are made by music publishers are written off because the songwriters can't earn them back.

So for the RIAA to suggest that all of the risk is on their side and none of the risk is on the music publisher and songwriters' side will not be borne out by the evidence.

Now, Judge Wisniewski, now I will turn to Professor Landes' benchmarks, and he is, as I've said, at the University of Chicago Law School, he is the co-author with Judge Richard Posner, a book entitled "Economic Structure of Intellectual Property Law," and many other scholarly publications. And he has spent his entire career thinking about the issues that are before this court and writing about those issues.

First what he will say is that a reasonable royalty must be adequate to create incentives for songwriters to create musical works. Not surprising since it's the first factor in 801(b).

Moreover, as he will testify as a matter of economic theory and as a matter of actual evidence, the statutory rate acts as a ceiling on what songwriters and music publishers can obtain in the market. That's not to say, and we're not suggesting, that you can set the statutory rate anywhere you want because the parties can bargain under that statutory ceiling. We understand, and will -- they will argue for rates that fall within a range of reasonableness based on benchmarks.

But what Professor Landes' first observation is, is that because you can bargain below the statutory rates, and the evidence will show that music publishers and songwriters have historically granted licenses below the statutory rates, because you can bargain below but no bargaining takes place above, it's important in setting the rate to be mindful not only of the range but where in the range a reasonable rate falls.

Here's what he does, and I'll try to walk through his analysis in the context of the physical

product of the benchmarks that he uses apply to all of our rates.

Now, as the court explained in SDARS, the key is to select benchmarks that are comparable.

What Professor Landes has done is he has examined benchmarks in the free market outside of Section 115 in which licensees are seeking both the right to use the song that's conveyed now by the compulsory license and the right to use the recording of that song, the master recording right that belongs to the record labels. And he concludes that if he can find transactions in which both sets of rights are licensed either separately or together, they provide the best evidence of a comparable benchmark.

So where does he start? He starts in the Ring Tone market. And the largest number of voluntary transactions about which you will hear come from the Ring Tone and master tone market.

Now, as we discussed this morning, there was a referral on Ring Tones and the Register has concluded for the purpose of this proceeding that

Ring Tones fall within Section 115. That referral was the culmination of a long dispute between the copyright owners and the record labels with respect to whether or not Ring Tones were covered by the compulsory license.

Now, although the Register has ruled now in 2006 that Ring Tones are covered, there were hundreds of market transactions involving Ring Tones that predated the Register's ruling, and each of the music publishers who will testify will discuss with the Court the rates that they have obtained, any market transactions for Ring Tones, and those are set out graphically at Tab 9.

And what this shows and what we will demonstrate is that in the freely negotiated Ring Tone market, which are snippets of the very songs that are the subject of the compulsory license and which the Register has now concluded are subject to compulsory licenses, the rates that music publishers obtain in the free market range from 10 to 15 percent and there are penny minimum, which I've not set out here, but the evidence will show

which are well in excess of the current statutory rate.

Now, Professor Landes has also analyzed agreements directly between record companies and music publishers with respect to these Ring Tones, and those agreements are the so-called New Digital Media Agreements -- New Digital Media Agreement, NDMA. There will be a lot of testimony about the NDMAs in this proceeding.

Those were a series of agreements entered into between music publishers representing the songwriters and major record labels that allowed the record labels to license Ring Tones to cell phone companies and other sellers of Ring Tones and to license both the recording, which they controlled, and the underlying composition, which the songwriters and music publishers controlled.

So now we have a set of voluntary agreements between record labels and songwriters and music publishers with respect to the precise right at issue here.

Now, they've been marked as restricted,

but I will ask the Court to turn to Tab 10, and there'll be a lot of testimony about this, which summarize those terms.

The key number, and provides the bottom end of Professor Landes' range of benchmarks, is the middle number which deals with wholesale revenue. And what we have here is an agreement between record companies and music publishers that say to the music publishers we will pay you on the greater of one of these three metrics: A percentage of retail revenue, which in the market is typically a $1.99 to 250, that's what Ring Tones sell for -- the math is not too hard from that -- or 20 percent -- I apologize -- a percentage of the revenue that's received by the record company, wholesale revenue, or a penny rate minimum.

And what Professor Landes does is he examines those agreements, he examines the many, many, many Ring Tone agreements that predate those agreements, and he says that is the bottom of my range of reasonableness, my market comparables, and that's set out in Tab 11.

So where's the top? Because without a top this couldn't be the bottom. The other principal set of market comparables that he examines come from the synchronization market. And the synchronization licenses, as I know the Court is aware of from prior proceedings, are licenses in which someone who is making a television show or a movie needs the right, which is not covered by any compulsory license, to synchronize music with audiovisual product. And what he finds, and there will not be any dispute with respect to this fact, is that in that market when purchasers of both sets of rights need both the song and the recording, the song and the recording share on a 50/50 basis. So 50 percent from that market comparable is the top of his range, and there are literally thousands and thousands and thousands of those agreements, all of which, the way that the 50/50 split is accomplished, is that both the record label and the music publisher or songwriter enter into MFN agreements, Most Favored Nations agreements which guarantee that they get the same amount.

So based largely, but not exclusively, but for the purposes of the opening, largely on these two sets of benchmarks which bracket his range, he concludes that royalty rates in this range are reasonable. That is, if compositions of music are paid between these two ends of the range, a percentage of the overall revenue -- the revenue is split for both the recording and the composition -- anywhere in this range between the bottom that is implied by the Ring Tone licenses and the NMDAs and the top, which is applied by the synchronization licenses, that that is a reasonable ratio that allows him to conclude that the rate is consistent with the market comparables.

So how does that work with respect to our proposed royalty rates? Let me start with the physical rate. Our physical proposal is for 12 and-a-half cents per song. And if the Court will examine Tab 11, what we see is that the proposed rate for physical is near the bottom of the Landes range.

When one takes into account how much is

paid for the recording and how much is paid for the underlying composition at our proposed rates, the rate falls at the very bottom of the range implied by the Ring Tone to synchronization range.

As a result, what he will conclude as a matter of economics is that the rate is reasonable because it falls within the benchmark of market comparables.

Now, what did the labels propose instead? Based on a flawed benchmark from the 1980 proceeding that was the subject of our in limine motion, and I'm not going to go through it in any detail now, they have come up with a rate which translates to 5 cents, and the only benchmark on which they draw for their 5-cent rate is this analysis, which I think is a misreading, and I think we will demonstrate to the court is a misreading, of the 1980 CRT decision. And they take what they claim is a retail percentage of revenue rate that was set by the CRT in 1980, even though, in fact, the rate was a penny rate, and they convert it into wholesale percentage and they

say that's the appropriate percentage to be applied not only to physical but to be applied across the board, 7.8 percent of revenue, which is a nickel. Needless to say we would need another sheet of paper to see how far below the range of reasonable benchmarks that proposed rate falls.

So what's their justification? Because apart from the precise rate, the entire RIAA effort to drive down the mechanical rate hinges -- hinges on their claim that the recording music industry is in economic distress. That's the claim.

Now, that's not a new claim because the same set of claims of the rates, as I've said, are back-to-the-future rates that they're proposing, they want to go back to the nickel rate 25 years ago. The argument is also a back-to-the-future argument because in Tab 13 I have quoted from the Copyright Royalty Tribunal decision of 1980 because every argument that will be made by the RIAA in this proceeding about economic woes of that industry was made and rejected in the 1980 proceeding.

So what did the Court say in this passage, the tribunal say? "We note that the record industry claims that an increase in the statutory mechanical rates will bankrupt great record companies and will force others to drastically cut their operations. We reject all of these claims, as we find no probative evidence in the record to support them." And, respectfully, what I suggest is that at the end of this proceeding this Court will reach the same conclusion. There is no basis in economic evidence that would entitle the RIAA to a mechanical rate of half of a current rate and a tiny fraction of what the benchmark ratios imply.

Now, we're going to prove this out of the documents of the RIAA and through our expert witness, Helen Murphy. Ms. Murphy is not a stranger to the recording music industry. She was the chief financial officer of two of the major record companies. Most recently she was the chief financial officer of the Warner Music Group, which is one the four remaining majors, and in the 1990s

she was the chief financial officer of Polygram Music, which has been absorbed into Universal. And what she will testify to is that although there has been a decline in top-line revenues, and we saw that in that earlier chart, the earlier graph that I directed the Court to, while there has been a decline in top-line revenues over the past several years, the profitability of the recording music business has increased despite piracy, despite all of the issues that they will raise, and it is projected to increase steadily, according to their own documents, over this period.

Now, having engaged in what was, undoubtedly, painful restructuring to ring some of the fact out of their operations and because of the higher profit margins on the digital products, and I'll talk about that in a moment, the digital sales yield higher profit margins for the record companies than physical sales, they are on the whole, the major record companies, as profitable or more profitable as they've ever been. And that's set out in this restricted document, Tab 14.

Tab 14, which is derived from data that was given to us by the RIAA, sets out from 1991 to 2005, the last year for which we actually have the full data, from 1991 to 2005 revenues for this industry, operating profits for this industry, and profit margins for this industry. And what it shows is that the profit margins in 2005 were the highest in the 15 years for which we have data.

So there's nothing that supports this tale of economic woe and there's nothing about the economic condition of the recording music industry that requires the Court to set a rate that is a fraction of the current rate and a fraction of the appropriate benchmark rate.

Now, there will be a lot of talk during this proceeding as well about economic prosperity of the music publishers, and what the RIAA will say is publishers are prospering, we're suffering, and you have to lower the rates.

Well, forget about the songwriters, and we'll talk only about publishers. But, again, their evidence on music publishers is as

unsupported in meaningful ways as their own evidence about themselves.

The evidence will be clear that from music publishers and songwriters the mechanical royalty revenues are not increasing at the rate implied by the increases in the statutory rates. So what they will say is don't worry about that. You, the music publishers and songwriters, you have other streams of income. You can earn synchronization license fees, which, of course, they earn as well, and you can earn performance royalties under a different set of rights. And because there have been increases in synchronization royalties and in performance royalties, they will say you don't have to do much with the mechanical rate and it justifies pushing it down. And I think we will be able to demonstrate to this Court that that is a misreading of 801(b), it is the exact opposite of the argument that Professor Ordover (ph) made to you in the most recently concluded proceeding in which he testified and this Court adopted that testimony about the

need to get full value for every different right and every different possible income stream.

And equally flawed is the fact that while it may be true that music publishers as a group and songwriters as a group are enjoying increased performance and synchronization royalties, it's not a one-to-one ratio for individual songwriters who are dependent upon the count of royalties. And what we will show over the course of this proceeding both on our direct case and, undoubtedly, on rebuttal, in light of the arguments that have been raised, is that songwriters who earn mechanicals don't necessarily earn equivalent amounts of performance royalties, they don't necessarily earn equivalent amounts of synchronization royalties, and if you cut the mechanicals of songwriters because of synchronization and performance royalties, for many, many songwriters, those other two streams will be totally irrelevant or certainly insufficient to make up the difference.

Now, the labels also claim that they need

lower rates to bring them in line with rates around the world. And, again, we have filed an in limine motion on this issue, and I'm not going to try to spend a lot of time on it today, but what we tried to say in the in limine motion is that a proper analysis of foreign rates, even if it has some meaning under the 801(b) factors, is a complicated exercise.

You can't simply cherry-pick one or two countries where you find a rate that you think is lower than the U.S. rate and say ah-ha, those are large countries, you should adopt their rates. Let's ignore -- so let's adopt the rate of the United Kingdom, let's adopt the rate of Japan, let's ignore the rate of Germany, it's too high, let's ignore the rate of France, it's too high, let's ignore the rest of the rates in Western Europe. These different countries set rates under different copyright regimes involving different rights and involve different marketplaces, and to draw on foreign marketplaces which involve different bundles -- often involve different

bundles of right. For example, in the U.K. there's no controlled composition clause, so the rate is the rate. That's not true here.

If we're going to use those as market comparables, it is incumbent upon the RIAA to show that the markets are really comparable and do a detailed analysis, and we're going to have to look at all of those markets because the evidence will eventually show that foreign rates are below U.S. rates in some places and they're above in others. And the key question is are the markets sufficiently comparable given the different copyright regimes and given the different bundles of rights so that you should look abroad rather than the domestic free market comparables that we are urging the Court to use as benchmarks.

So what will they say about the Landes benchmark ratio that's set out in that chart? What they will say is they were coerced into entering into the New Digital Media Agreements. What they will say, but the evidence will not ultimately support, what they will say is at the time they

entered into those NDMAs they wanted to license some other products that were outside of 115. As for the Ring Tones at that time, they wanted to license dual disks, they wanted to license locked-content product, they wanted to license -- that may or may not have been outside of 115 -- they wanted to license audiovisual product. And what they will say is they had to enter into these NDMAs, they, these gigantic record companies, had to enter into the NDMAs at the rates that you will hear about that informed the Landes benchmark because they needed those other products, and we will demonstrate that that's simply not so. And what the evidence will show and what is most important to Professor Landes as an economist is that the NDMAs do not represent a departure from the preexisting market comparables. The rates in the NDMAs are consistent with the preexisting market comparables and represent a continuation of that market. Thus, we'll be able to demonstrate and the evidence will show and Professor Landes will opine, based upon his economic judgment, that

the NDMA rates do not reflect some enhanced price that the labels paid as a result of their purported desire to license other product.

So what are they going to say about the top end of our range, the sync markets? You're not going to hear any evidence that sync agreements are not 50/50 agreements. Again, they have to fall back on the coercion argument. They're somehow forced to enter into licenses at below some hypothetical market rate because a synchronization licensee, somebody who wants to put music and time relation to the song, they will say can bypass the recording. So they can take less than they would ordinarily get, they take less than the fair value.

The argument doesn't make any sense particularly because it equally applies to the song. There is no, with very few exceptions, there's no reason to use one specific song in a movie and a television show. There are genres of songs, there are similar songs, and if the songwriter were to demand too much, a synchronization licensee can bypass the song in the

same way that they can bypass the recording, and it happens in the real world when publishers and songwriters ask too much for their song.

The fact of the matter is, and what the synchronization licenses show and why they provide the endpoint of the Landes benchmark ratio, is that in a free market without a compulsory license the fact of the matter is that licensees who need the song and need the recording pay equal amounts for those two rights.

CHIEF JUDGE SLEDGE: Mr. Cohen, do the rules of evidence prevent admission of evidence on the intent and goals and the negotiations of parties when an agreement has been reached absent fraud?

MR. COHEN: Well, I think that's a matter of discretion. For, Your Honors, I think that if you're asking me can you take parole evidence, the agreements are clear on their face; is that the question? I think that's typically a matter of substantive law rather than parole evidence.

CHIEF JUDGE SLEDGE: So absent ambiguity,

then all of what you've been describing plus what Judge Wisniewski asked you about the relevance of the owners earlier would not even be admissible evidence?

MR. COHEN: Well, respectfully, I think that's not correct I can answer for two reasons. First, with respect to these benchmarks, I'm not offering intent of the parties. I'm offering the marketplace evidence of what the rates are. So perhaps I misspoke in the course of my opening, but the point of the benchmark ratios is to say this is the ratio between the song and the recorded product at one end that comes out of agreements and this is the ratio between the song and recorded product at the other end. I believe it's the RIAA who will seek to escape the rates in those agreements by arguing without intent.

With respect to the 1997 agreement and what the parties intended, it's really intended to give the Court useful background about how we got to where we are and why we are today.

CHIEF JUDGE SLEDGE: Well, if those

matters are as much a part of the evidence as your opening is indicating, perhaps this proceeding will be a lot shorter than people expect.

MR. COHEN: That would be up to the Court.

I think you will find the evidence important in understanding how we got to where we are with respect to the rates.

Let me just say one more thing about physical product before I move on to digital product, and that is with respect to the structure. I think, as I've said, at the beginning of my opening, we propose continuation of the penny rate structure that's been in place for a hundred years. Historically, the evidence will show the mechanical rate hasn't moved the price of product to when there were multiple physical formats in the market; records, LPs, CDs and cassettes. The same mechanical penny rate applied to each one of those even though they were priced differently in the market.

Moreover, and I think this ties into what

the Court said in both Webcasters II and in the recent SDARS' decision, the penny rate, of course, is a usage base metric. It moves directly with the number of units of songs that are sold, whereas the percentage of revenue range, either wholesale or retail, but the wholesale rate as well that the RIAA proposes, is not so directly tied to the use of music. And, in fact, there will also be some disruption, Your Honors, as you see when you look at the written direct case of the RIAA, even they in advocating a percentage of revenue ask for a percentage phase-in because they recognize that the royalty systems will have to be redone to move from a hundred-year penny rate to a percentage of revenue.

So what the evidence will show in the aggregate is we are proposing a usage-based metric. It avoids the measurement difficulties involved with revenue that the Court has commented on in prior proceedings and the other side has not proffered any compelling reason why we should move off of the penny rate.

So what do they say? What they say is they need a percentage of revenue rate, they need the flexibility so that they can offer a low-cost product and that they can offer new products that are not possible in the penny rate regime. And what the evidence will show, and Professor Landes will deal in the first part of this. Is that the copyright owners have historically granted concessions from the statutory rate in order to allow the introduction of budget product. And the evidence will show, and the RIAA will testify, that this entire plethora of digital products that have been introduced into the marketplace had been introduced under the penny rate regime. So the burden I think should be high, the typical rate will use this base metric, and I don't think the evidence will support it.

Let me turn, if I can, and I will be briefer with respect to the other rights, to permanent downloads. And, again, if you will pull from Tab 7, here we are also proposing a penny rate of 15 cents per song. It's higher than the rate on

physical, but it's a penny rate index for inflation. And what we mean by a permanent download is the sale of a song or an album over the Internet in return for a fixed fee, and in today's market the overwhelming percentage of those sales are through the Apple iTunes store.

Now, many of the factors that lead to the need for the increase in the physical rate apply as well with respect to permanent downloads, and I'm not going to reference that now. But there is one factor relating to the structure of the digital market that requires some discussion and cancels for a higher rate, and that's this.

The historical physical market was an albums-based market. Songs were sold in bundles of 10, 12, 13, 14 songs, it increased as we moved from LPs to CDs, and the overwhelming majority of those sales meant that songs were essentially sold 13 at a time.

In this new digital market, while there are album sales, the evidence will show that there has been an unbundling of the sale of music. Songs

are increasingly sold one by one as consumers pick hit singles from albums and buy just the hits and leave the other 12 songs behind. And what Professor Landes will testify to is that, as a matter of economic theory, this unbundling requires a higher rate for the single-based market in order to adequately compensate and create the correct incentives for songwriters.

Now, where does it fall within his benchmarks? If we go to Tab 11, what we will see -- and, again, there's no real factual dispute on this -- according to public information, public information, iTunes, which has about 85 percent of the market, iTunes pays the record labels approximately 70 cents on the 99-cent song that it sells. It sells it online for 99 cents, the record companies get 70 cents. And the record companies, which have elected to engage in pass-through licensing -- they are acquiring mechanical licenses on behalf of Apple -- it's different than subscription services -- but here on permanent downloads the record companies are telling Apple

you pay us 70 cents and we will take care of the mechanical licenses as well.

So if we look at the Landes benchmarks and we say where this 15 cents out of 70 cents fall on the range of reasonableness based on market transactions, as to what is the appropriate split between the recorded music product and the song, we see it's at the very low end of the range and leads us to conclude that it's reasonable and it's consistent with the hundreds and hundreds of Ring Tone agreements that were entered into in the free market with respect to the split between the song and the recording.

Now, is there anything in 801(b) that should require the court to depart from this market benchmark for permanent downloads? I think one set of facts bear particular mention and help the Court answer the question in the negative, which is that this rate, the rate that we propose will not only offer a fair return to the copyright owners, it will allow the copyright users to have a fair income in existing economic conditions.

As I said earlier, and I don't think that -- with respect to the record labels, the evidence will show that the labels themselves have asserted and claimed that their profit margins on digital product is higher than on physical product mostly because of the absence of manufacturing and distribution.

Why that's important with respect to the period that's at issue in this proceeding is that we are moving to an increasingly digital sales model in the recording music side.

If we look at -- I want to show the Court one more chart -- Tab 17, what we see is that over the three years for which we have evidence here, and this trend is continuing, that basically from the standing start in the digital business the business of the recording music companies, the record labels, is increasingly a digital business, and it's increasingly a digital business where they earn higher margins than they do on the physical side.

Now, there may be some testimony in which

labels will attempt to persuade you that digital margins aren't higher, but it is completely inconsistent with their public statements.

If you turn to Tab 16, I have one quotation which is important because it summarizes a lot of what the evidence will show. And this is a public document, and it's from EMI's 2005 annual report to its shareholders, EMI being one of the four major record companies. And this is a letter from Eric Nicoli, who was then the chairman of EMI, in charge of the entire company worldwide to the shareholders of EMI, and what does he say about the digital business? "Certain costs borne in the physical world such as manufacturing returns and Pick, Pack, Ship are not relevant for digital products. For physical products these costs are in the range of 15 to 18 percent of sales.

"While there are some digital specific variable costs and infrastructure investments needed to fully pursue the digital opportunity, it is reasonable to expect that our company will be more profitable as digital sales grow as a

proportion of our business." And we will demonstrate that this is precisely what is occurring. And although the industry consensus from public data is the about $1 billion digital music business that exists in the U.S. today, or at least in 2006, will exceed $5 billion by 2012. And we will show the record companies' own forecasts with respect to the digital business and demonstrate that on the permanent download side the increase that we are seeking can be readily absorbed by them because of their increased profit margins.

Now, what about the DiMA companies? What about Apple as the permanent download provider? Since it's launch in 2003, iTunes has dominated the market.

We will submit evidence from an industry expert, Claire Enders, who has analyzed the development of the digital market, and as she will say, and again it's public, Apple has got about 85 percent. And although DiMA will devote the majority of its case on permanent downloads and on

subscription to try to persuade the Court that somehow the digital services are just getting by, that is certainly not true for iTunes.

And what I've done in Tab 18, and this is restricted information, is to show you the magnitude of what the iTunes business has become both in terms of the number of songs, the revenue that they're earning, and their contribution margin. But to talk about the struggling digital musical companies, and we'll deal with the others in a few minutes, has no applicability based on the evidence for iTunes. And what's really remarkable about iTunes is that this success really seems to have been unintended because what Apple has said in statement after statement after statement, and in Tab 19 I quote an earnings call from the chief financial officer of Apple from the Spring of 2007, is that they have said "Our philosophy has been to run the music store just a little bit over break-even because we think that selling music and now videos helps us to sell iPods and accessories."

There isn't anything about our proposal

that's going to interfere with that business strategy, and we will demonstrate that quantitatively and through testimony.

Let me turn to limited downloads and streaming. Again, what we propose here is a slightly different set of rates, and they're summarized in Tab 7.

What we propose here is a three-part rate, which is the greater of percentage of revenue or percent of total content cost fitting into the Landes benchmark ratio, or fractional penny rate.

Now, it would be a lot easier for us if we could simply apply a simple rate to limited downloads and interactive streaming. So what is the reason for this three-part rate and why are we seeking a different rate structure than the penny rate that we're seeking for physical and for permanent downloads?

The answer, and it's an important answer, is the business models are really unsettled and there are -- typically now the way that these services charge, and they're typically subscription

models, is that the subscription services charge a set amount to consumers. But the business is moving. We don't know which way it's going to land in 2008 to 2012. There's a service called Spiral Abroad (ph), which you'll hear testimony about. That's an advertising-based service. There are some subscription services that charge higher prices and some that charge lower prices because they want to drive eyeballs to their website and earn different revenue.

And in these evolving models what we've attempted to do is to set out rates that mimic the structure of the rates of the contracts that have been entered into by the record companies because what the evidence will show is that the record companies also have three-part rates in their voluntary agreements. Because of the uncertainty of this market, they're not content to take a penny rate, although they have a penny rate piece; they're not content to take a percentage of revenue, although they are have a percentage of revenue piece; and they're not content to take a

per subscriber fee, although they have those pieces.

So what we have attempted to do in this evolving market is to say that we should be entitled to the same protection with respect to the structure of the rate as the record companies who have entered into these free-market negotiations, and what we have done is to benchmark what we are seeking against the total amount that they are seeking. By saying no more than a third, what we are saying is that we are seeking a percentage of the total content pool, the total amount paid for music, for the recording and for the song that fits squarely within the Landes benchmark ratio based on Ring Tone agreements and based on the synchronization licenses. And, you know, setting the rate right here is particularly important because, as you will hear -- we had a little bit of discussion about this morning -- this industry, the subscription industry, the interactive streaming and limited download industry, was launched when the music publishers and songwriters agreed to

rateless deals in 2001.

The copyright owners have invested in this business by essentially giving them a free license for these past seven years and what's required now, I respectfully submit, is a rate based on the benchmarks that gives fair value for the copyright owners for the investment that they made in this business that has allowed this business to begin to develop.

Now, what do our opponents say about this rate? The first thing that DiMA says is they can't afford it. They can't afford it. They're paying too much to the record companies to pay a royalty that we think is implied by the benchmarks to the owners of the music. And I think our first answer to that comes from Webcasting, and I think it applies with particular force here, and it's in Footnote 7 of the Webcasting decision, which I've excerpted in the last tab, which is to say, "To allow inefficient market participants to continue to use as much music as they want and for as long a time period as they want without compensating

copyright owners on the same basis as more efficient market participants trivializes the property rights of the copyright owners."

The fact of the matter is that the interactive streaming services and limited download services have entered into agreements with the record labels which have provided for a substantial percentage -- we'll demonstrate the numbers -- a substantial percentage of their revenues to be paid to the record companies. And there is nothing about rate setting under Section 115 that should say or does say that copyright owners, because they have a compulsory license, are relegated to some table scraps, whatever is left after they've fed the record companies. It might have been the price of getting into that business they could not have entered into rateless deals with the record companies, but the fact that we did so under the compulsory license does not mean that we have to take the bargain-basement rates that they are proposing.

Now, they do offer a rate on the DiMA

side for the subscription services, and that is a 4 percent rate. And they will offer the testimony of their economist, Ms. Karen Calvern (ph), and we will deal with her testimony, and we have also raised some issues in an in limine motion, but the fact of the matter is there is no market benchmark that supports a 4 percent rate and there is no market benchmark that supports the multiple between what they are offering the owners of the songs and the owners of the recordings and it's way outside of the Landes benchmark rate.

Finally, on Ring Tones, again, our proposal is in Tab 7. What we're seeking here is the greater of 15 percent of revenue for a third of content costs or 15 cents per Ring Tone.

This one is an easy one for us at least. You will hear testimony about all the market benchmarks. There are many, many, many Ring Tone agreements.

The rates that we are seeking are supported by those agreements. They are -- in fact, they are supported on the percentage of

revenue side. They are supported on the penny minimum. In fact, because of the pricing of Ring Tones, there are many Ring Tone agreements that pay music publishes and songwriters today penny rates well in excess of the minimum that we're seeking. And Professor Landes has looked at these agreements. They fall clearly within his benchmark ratio of comparable marketplace agreements, and he finds them to be reasonable.

And before I sit down I want to spend thirty seconds just talking about one term that we propose because each of us has proposed certain changes in terms that are important, and the one that's important to us -- they're all important -- but the one that I want to mention in the opening is we are proposing for the first time a late fee of 1 and-a-half cents per months, as well as a 3 percent charge for pass-through licensing in situations such as the iTunes situations where the labels take it upon themselves to acquire the mechanical license for iTunes rather than iTunes being licensed directly, and that may be their

right under the Copyright Act. I'm not disputing that. But the fact of the matter is that these pass-through licenses delay our payments and the evidence will show that record companies are chronically late on the payment of mechanical royalties. And as this Court observed in each of the last two proceedings of Webcasters II and the SDARS' proceeding, timely payment is essential to the statutory scheme, and that's all we're seeking to achieve through those change in rates.

So in conclusion, the evidence will show that songwriters and music publishers are proposing rates that are comparable, consistent with market comparables, they satisfy the objectives of 801(b), they can be absorbed by the RIAA and DiMA companies without any disruption of their business, and, by contrast, what we're being offered in return are throw-back rates to the 1980s that are wildly outside of the contemporary market benchmarks and if those rates were adopted, would wreak economic havoc on the songwriters who write the songs that the RIAA companies record and that the digital

companies sell.

CHIEF JUDGE SLEDGE: Thank you.

I'm sure Mr. Cohen carefully planned his presentation to end at noon. We will recess until 1:00 o'clock.

(Whereupon, at 12:06 p.m., a luncheon recess was taken.)

* * * * *

CERTIFICATE OF NOTARY PUBLIC

I, SHARI R. BROUSSARD, the officer before whom the foregoing hearing was taken, do hereby certify that the testimony appearing in the foregoing pages was taken by me in stenotypy and thereafter reduced to typewriting under my direction; that said transcription is a true record of the testimony given by said parties; that I am neither counsel for, related to, nor employed by any of the parties to the action in which this hearing was taken; and, further, that I am not a relative or employee of any counsel or attorney employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

SHARI R. BROUSSARD

Notary Public in and for the

District of Columbia

My commission expires:

July 14, 2010

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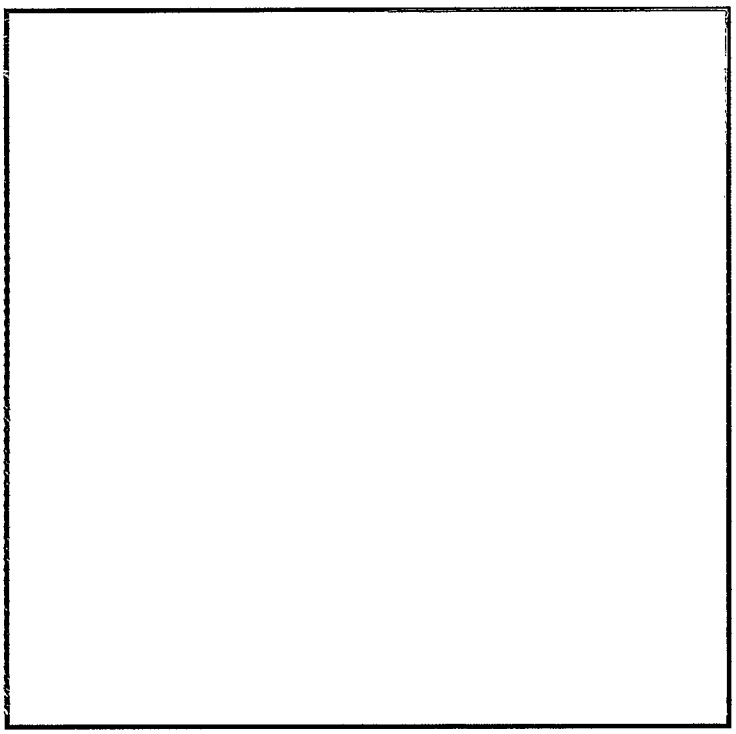

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